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**Special Series: Economic Recovery Watch**

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## HOUSE RECOVERY PACKAGE WOULD GIVE 3.8 MILLION LOW- AND MODERATE-INCOME STUDENTS — THOUSANDS IN EVERY STATE — ACCESS TO HIGHER-EDUCATION TAX CREDIT

By Arloc Sherman and Chye-Ching Huang

The “Hope Credit,” which provides a tax subsidy for college tuition costs, was established in 1997. Its goal, in part, was to enable students who could not otherwise afford to attend college to do so. Yet today, 3.8 million prospective college students — more than a fifth of all high-school-age children nationwide — cannot expect to receive *any* help from this tax credit because their families’ incomes are too low to qualify for it.<sup>1</sup>

The tax component of the economic-recovery package the House Leadership unveiled last week would address this issue. It contains a temporary measure to enlarge the Hope credit for students from middle-income families *and* to partially extend this tax credit for the first time to students from lower-income families. The proposal also would rename the Hope Credit as the American Opportunity Tax Credit.

### Current Credit Shuts Out Families that Most Need Help Affording College

Currently, the Hope Credit is not “refundable.” This means that it can benefit only students from families with incomes high enough to owe federal income tax. As a result, students from lower-income families cannot qualify for it. This year, a student from a family of four with income of less than \$26,000 (more than twice full-time minimum wage earnings) is shut out of the credit entirely for this reason. Moreover, a student from a four-person family cannot qualify for the full Hope Credit of \$1,800 unless his or her family has income of more than \$43,567.<sup>2</sup>

In contrast, if a tax credit is “refundable,” low-income households that otherwise are eligible can qualify; they can receive a tax “refund” in the amount that the credit exceeds their income tax liability. Based on Census data for 2004-2006, we estimate that about 3.8 million high-school-age children (ages 14-17) live in lower-income families that currently can not expect to benefit from the Hope Credit if their children go to college, simply because the credit is not refundable.<sup>3</sup> Table 1

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<sup>1</sup> For more on the bill’s Hope Credit provisions, see <http://www.cbpp.org/1-21-09tax2.htm>

<sup>2</sup> This figure assumes that the family does not qualify for other non-refundable credits such as the DCTC.

<sup>3</sup> In practice, many more likely would not benefit because of the credit’s narrow definition of qualifying expenses. See Chye-Ching Huang, Robert Greenstein, and Gillian Brunet, “House Recovery Package Would Improve Higher-

shows the number of such students in each state; these are the numbers of students who, as a result of the policy change in the House package, no longer would be automatically shut out of the credit.

## House Proposal Would Expand Credit and Make It Partially Refundable

The House proposal would increase the maximum Hope Credit from \$1,800 to \$2,500, and allow it to be claimed for a maximum of four years of qualifying education instead of the current two years. The proposal also would make up to 40 percent of the credit refundable, enabling households with little or no federal income tax liability to receive a credit of up to \$1,000.<sup>4</sup> This would mean that the 3.8 million low- and moderate-income students who currently cannot expect to benefit from the credit could expect a partial tax credit if they went to college.<sup>5</sup> This step is laudable for four reasons.

- It would help the credit fulfill its basic purpose of promoting college enrollment, by reaching the students for whom it would have the largest impact on college enrollment decisions. Common sense suggests — and academic research corroborates — that subsidies for college costs are likely to have the largest impact on the college-enrollment decisions of students with low or moderate incomes.<sup>6</sup> According to the Congressional Research Service, studies consistently find that “lower-income students [are] more sensitive to changes in tuition and aid than students from middle- and upper-income families.”<sup>7</sup>
- It would make college somewhat more affordable for students who now can barely afford it. Some mistakenly believe that governmental and school-based aid is sufficient to insulate low-income students from high college costs and that these students consequently do not need the assistance that education tax benefits provide. But the National Center for Education Statistics reports that the large majority of low- and moderate-income college undergraduates have significant unmet financial need even *after* taking into account all governmental and institutional grants, subsidized loans, work study, and other aid they may receive.<sup>8</sup>
- It would make the credit more equitable: low- and moderate-income students ought to have access to subsidies for college costs that Congress provides to students from families with higher incomes.
- This would be particularly helpful during the current recession. When the labor market is weak and many people are unable to find jobs, one of the best long-term investments the nation can make is to upgrade the skills of unemployed workers. The more that otherwise unemployed Americans receive additional education and skills during the downturn, the more productive the

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Education Tax Credits, January 21, 2009, Center on Budget and Policy Priorities, <http://www.cbpp.org/1-21-09tax2.htm>.

<sup>4</sup> To receive a credit of \$1,000, a low-income student would need to have at least \$4,000 in qualifying education expenses. See <http://www.cbpp.org/1-21-09tax2.htm>. The House Ways and Means Committee Package would also rename the Hope Credit the “American Opportunity Tax Credit.”

<sup>5</sup> <http://www.cbpp.org/1-21-09tax2.htm>

<sup>6</sup> <http://www.cbpp.org/1-21-09tax2.htm>

<sup>7</sup> Pamela J. Jackson, “Higher Education Tax Credits: An Economic Analysis,” Congressional Research Service, updated February 20, 2007, [http://opencrs.cdt.org/rpts/RL32507\\_20070220.pdf](http://opencrs.cdt.org/rpts/RL32507_20070220.pdf).

<sup>8</sup> <http://www.cbpp.org/1-21-09tax2.htm>. This paper also explains that, even with the proposed increase in Pell Grants contained in the House recovery package, large levels of unmet need will remain among many students from low-income families.

American workforce will be — and the more competitive American firms will be — in the decades ahead.

**TABLE 1:**  
**Families who Cannot Benefit Unless the Tax Credit is Refundable**

<b>State</b>	<b>Number</b>	<b>Margin of Error</b>
Alabama	70,000	±15,000
Alaska	7,000	±2,000
Arizona	75,000	±17,000
Arkansas	44,000	±9,600
California	522,000	±44,800
Colorado	36,000	±11,700
Connecticut	30,000	±9,100
Delaware	8,000	±2,400
D.C.	10,000	±2,300
Florida	195,000	±25,900
Georgia	120,000	±20,000
Hawaii	11,000	±3,100
Idaho	20,000	±4,700
Illinois	156,000	±23,300
Indiana	76,000	±16,000
Iowa	25,000	±7,800
Kansas	33,000	±8,600
Kentucky	72,000	±15,100
Louisiana	77,000	±15,800
Maine	17,000	±4,600
Maryland	53,000	±13,600
Massachusetts	71,000	±15,400
Michigan	121,000	±20,300
Minnesota	41,000	±11,800
Mississippi	63,000	±11,700
Missouri	74,000	±15,800
Montana	12,000	±3,000
Nebraska	17,000	±4,900
Nevada	32,000	±8,200
New Hampshire	9,000	±3,000
New Jersey	77,000	±16,400
New Mexico	36,000	±8,000
New York	295,000	±32,600
North Carolina	118,000	±20,200
North Dakota	6,000	±1,800
Ohio	128,000	±20,600
Oklahoma	53,000	±12,200
Oregon	41,000	±11,400
Pennsylvania	138,000	±21,700
Rhode Island	14,000	±3,600
South Carolina	58,000	±13,800
South Dakota	7,000	±2,000
Tennessee	87,000	±17,100
Texas	346,000	±37,200
Utah	24,000	±6,300
Vermont	5,000	±1,700
Virginia	71,000	±15,500
Washington	67,000	±15,600
West Virginia	27,000	±5,600
Wisconsin	63,000	±14,700
Wyoming	5,000	±1,500
<b>United States</b>	<b>3,762,000</b>	<b>±107,900</b>

Source: CBPP estimates based on data from the 2005-2007 Annual Social and Economic Supplements to the Census Current Population Survey, which cover years 2004-2006. Figures are averages for 2004-2006, based on 2009 tax law.

The estimates refer to numbers of high-school-age children, rather than those of college age, because Census data do not link college-age children living away from home with the incomes of their parents. We take the number of high-school-age students in families with too little tax liability to benefit from a non-refundable education tax credit as an indicator of what the number will be in four years when these same children reach college age. The estimates shown here may be too conservative insofar as they do not take into account any other tax credits or deductions to which families may be entitled, and thus may understate the number of families with insufficient tax liability to benefit from the credit. We adopted this conservative approach because we needed to examine families with high school students and it is difficult to determine how the parents' tax liability may change when their children are college-age.